

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Oller Analyst: Kristina E. North Bill Number: SB 155

Related Bills: See Prior Analysis Telephone: 845-6978 Amended Date: March 28, 2001

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Prescription Drug Refundable Credit

- ☒ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced January 31, 2001.
- ☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- ☒ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced January 31, 2001.
- ☒ FURTHER AMENDMENTS NECESSARY.
- _____ DEPARTMENT POSITION CHANGED TO _____.
- ☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED JANUARY 31, 2001, STILL APPLIES.
- ☒ OTHER - See comments below.

SUMMARY

This bill would allow a refundable credit to individuals 55 years of age or older for 100% of the costs of their prescription drugs that are not reimbursable by a third party.

SUMMARY OF AMENDMENT

The March 28, 2001, amendments resolved two implementation concerns and partially resolved another implementation concern. Except for the resolved implementation concerns, the remainder of the department's analysis of the bill as introduced still applies. The remaining policy and implementation concerns and departmental costs have been included below.

POSITION

Pending.

Summary of Suggested Amendments

An amendment is suggested to provide appropriation language to fund the departmental costs associated with administering the proposed credit.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Legislative Director

Date

Brian Putler

04/12/01

ANALYSIS

THIS BILL

The March 28, 2001, amendments would:

- Define "prescription drugs" as insulin or a drug dispensed by a licensed pharmacist, or oxygen, as prescribed by a licensed physician or other health professional for the taxpayer's use;
- Specify that the amounts paid for prescription drugs must not be reimbursable by a "third party" in order to qualify for the credit;
- Specify the credit is for the taxpayer's own prescription drugs; and
- Specify that no deduction would be allowed for any amount used to claim this credit.

The March 28, 2001, amendments specify that any credit in excess of the taxpayer's tax liability would first be credited against other amounts due, and the balance, upon appropriation by the Legislature, would be refunded to the taxpayer.

IMPLEMENTATION CONCERNS

A definition is needed for "not reimbursable." It would be difficult to determine whether a particular drug expense is "reimbursable."

This bill does not specify when a taxpayer would need to reach age 55 before claiming the credit. As written, the department would allow the credit to a taxpayer that reaches age 55 or older by December 31st of the taxable year.

This bill would require regular appropriations by the Legislature to pay for the refundable portion of this credit. If sufficient funds were not appropriated to cover all of the refunds due, the department would suspend payment of the refunds until additional funds were appropriated.

Since the proposed credit is refundable, the credit would need to be shown in the payment section on all personal income tax (PIT) returns except the Form 540 2EZ. This would increase PIT return Forms 540, 540NR, 540X, and potentially the 540A by one page. Adding a page to these forms would result in a significant impact on Franchise Tax Board's operations and costs, would slow return processing, and would increase the amount of return storage space. The department may be required to lease additional office and file storage space, however the department would work within available space to the extent possible.

An undetermined number of fraud investigators may be required by the department to verify this credit. Administrative costs of such investigators have not been determined at this time, but are expected to be significant.

FISCAL IMPACT

The department costs to implement this credit are estimated to be \$2.8 million with 58 personnel years (PYs) in the first year and \$2.3 million with 55.2 PYs in the second year.

ECONOMIC IMPACT

Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would potentially result in very significant revenue losses under the Personal Income Tax Law as follows.

Estimated Revenue Impact of SB 155 As Amended March 28, 2001 [\$ In Millions]		
2001/2002	2002/2003	2003/2004
-\$1,300	-\$1,480	-\$1,760

Tax Revenue Discussion

The revenue impact of this bill would be determined by the amount of credits generated and reported on tax returns.

As a refundable credit, revenue losses would be attributed to qualified individuals who are currently filing returns, or are not currently filing returns since they do not have a filing requirement. Tax return data indicates the number of individuals ages 65 or older who currently file tax returns. The number of additional individuals not currently filing tax returns was approximated by deducting the number currently filing from the state's population of individuals ages 65 or older.

Based on household spending data for 1997, the average annual out-of-pocket expenditure for prescription drugs by individuals age 65 and older was projected at \$675 for 2001. It is assumed that taxable filers would incur the average annual out-of-pocket costs for prescription drugs, and that nontaxable filers and non-filers would incur annual costs equal to one-half of the average due to lower incomes.

Potential credits for individuals age 65 and older were derived as follows:

- Multiplying the number of currently taxable filers by annual out-of-pocket costs for prescription drugs of \$675, and making allowance for (1) some small portion deducted under current law as a medical expense (subject to the 7.5% of AGI threshold) and (2) the rate at which these taxpayers would actually report the credit on their tax returns;
- Assuming that one-half of currently nontaxable filers would incur annual out-of-pocket costs for prescription drugs equal to half that of the group above, or \$338;
- Assuming that one in four non-filers would also incur average out-of-pocket costs for prescription drugs of \$338, and making allowance for only half of these filing in the initial year; and
- Summing credits generated for individuals ages 65 or older.

To derive total credits generated, the result from above was increased an additional 25% to represent qualified taxpayers ages 55 to 64. This was based on the proportion of the population ages 55-64 relative to all those ages 55 and older and reflects that individuals ages 55-64 spend less on prescription drugs.

POLICY CONCERNS

Credits generally are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, which is unprecedented.

This bill does not specify a repeal date. Credits typically are enacted with a repeal date to allow the Legislature to review the effectiveness of the credit.

Historically, refundable credits such as the prior state renter's credit and the federal Earned Income Credit have had significant problems with invalid and fraudulent returns. These problems are aggravated if a refund made to a taxpayer is later determined to be fraudulent. The refund commonly cannot be recovered.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 155
As Amended March 28, 2001

AMENDMENT 1

On page 2, line 29, following "SEC. 2" insert:

(a) There is hereby appropriated from the General Fund for expenditure in the 2001-2002 fiscal year the sum of two million eight hundred thousand dollars (\$2,800,000) for allocation to the Franchise Tax Board in augmentation of Item 1730-001-0001 of the Budget Act of 2001.

(b) Any funds that are allocated pursuant to subdivision (a) shall be expended by the Franchise Tax Board solely for the purposes of implementation and administration of the Refundable Prescription Drug Credit under Section 17053.97 of the Revenue and Taxation Code.